

**INTERNAL MARKETING AND CUSTOMER LOYALTY:
MEDIATING EFFECT OF RELATIONSHIP MARKETING**

by

SIM HOCK SENG

**Research report in partial fulfilment of the requirements for the degree of
Master of Business Administration**

APRIL 2006

ACKNOWLEDGEMENT

Firstly, I would like to express my deepest gratitude to Dr. Norizan Saad for his guidance and supervision. His wide experience and exposure in the field of relationship and internal marketing helped to clarify doubts, provided me with critical ideas and suggestions that deepen my understanding of the concepts.

Many thanks to my friends who assisted me in questionnaires distribution, text editing and data analysis.

A very special thank to all the respondents to my questionnaires who spend their precious time in providing their views. They have made important contribution to the completion of this thesis.

Foremost, I am would like to take this opportunity to thank my wife and parents for their continuous support, understanding and motivation during the past one year. For their tolerance of my mid-night works and weekends absence.

TABLE OF CONTENTS

	<u>Page</u>
TITLE	i
ACKNOWLEDGEMENT	ii
TABLE OF CONTENTS	iii
LIST OF TABLES	v
LIST OF FIGURES	vi
ABSTRAK (MALAY)	vii
ABSTRACT	viii
 Chapter 1 INTRODUCTION	
1.1 Introduction	1
1.2 Background	1
1.3 Significance of Study	3
1.4 Problem Statement	3
1.5 Research Objectives	4
1.6 Research Questions	5
1.7 Organisation of Chapters	5
 Chapter 2 LITERATURE REVIEW	
2.1 Introduction	6
2.2 Internal Marketing	6
2.3 Relationship Marketing	9
2.3.1 <i>Trust</i>	11
2.3.2 <i>Bonding</i>	12
2.3.3 <i>Communication</i>	12
2.3.4 <i>Shared Value</i>	13
2.3.5 <i>Empathy</i>	13
2.3.6 <i>Reciprocity</i>	13
2.4 Customer Loyalty	14
2.5 Internal Marketing and Relationship Marketing	16
2.6 Relationship Marketing and Customer Loyalty	17
2.7 Theoretical Framework	19
 Chapter 3 METHODOLOGY	
3.1 Introduction	21
3.2 Research Design	21
3.3 Sampling and Procedure	21
3.4 Measurement	22
3.4.1 <i>Internal Marketing</i>	22
3.4.2 <i>Relationship Marketing</i>	23
3.4.3 <i>Customer Loyalty</i>	23
3.5 Statistical Analyses	26
3.5.1 <i>Factor Analysis</i>	27
3.5.2 <i>Reliability Analysis</i>	27
3.5.3 <i>Regression Analysis</i>	28
3.5.4 <i>Hierarchical Multiple Regression Analysis</i>	28

Chapter 4	RESULTS	
4.1	Introduction	29
4.2	Profile of Respondents	29
4.3	Goodness of Measures	31
4.3.1	<i>Factor Analysis of Internal Marketing</i>	31
4.3.1.1	<i>Measure of Sampling Adequacy</i>	31
4.3.1.2	<i>Principal Components Analysis</i>	31
4.3.2	<i>Factor Analysis of Relationship Marketing</i>	32
4.3.2.1	<i>Measure of Sampling Adequacy</i>	33
4.3.2.2	<i>Principal Components Analysis</i>	33
4.3.3	<i>Factor Analysis of Customer Loyalty</i>	33
4.3.3.1	<i>Measure of Sampling Adequacy</i>	33
4.3.3.2	<i>Principal Components Analysis</i>	35
4.3.4	<i>Reliability Analysis</i>	35
4.4	Revised Hypotheses	36
4.5	Testing of Hypotheses	37
4.5.1	<i>Testing of Hypothesis 1</i>	37
4.5.2	<i>Testing of Hypothesis 2</i>	41
4.5.3	<i>Testing of Hypothesis 3</i>	42
4.6	Summary	44
Chapter 5	DISCUSSION AND CONCLUSION	
5.1	Introduction	46
5.2	Recapitulation of Findings	46
5.3	Discussion	47
5.3.1	<i>Relationship between Internal Marketing and Relationship Marketing</i>	47
5.3.2	<i>Relationship between Relationship Marketing and Customer Loyalty</i>	48
5.3.3	<i>Mediating Effect of Relationship Marketing to the Relationship between Internal Marketing and Customer Loyalty</i>	49
5.4	Implications	50
5.5	Limitations	51
5.6	Future Research	51
5.7	Conclusion	52
	REFERENCES	53
	APPENDICES	
Appendix A	Questionnaires	58
Appendix B	Frequencies	64
Appendix C	Factor Analysis	67
Appendix D	Reliability Analyses	73
Appendix E	Descriptive Analysis	80
Appendix F	Regression Analyses	81

LIST OF TABLES

		Page
Table 3.1	Summary of Measure: Internal Marketing	24
Table 3.2	Summary of Measure: Relationship Marketing	25
Table 3.3	Summary of Measure: Customer Loyalty	26
Table 4.1	Summary of Respondents' Demographic Profile	30
Table 4.2	Rotated Factor and Factor Loadings of Internal Marketing	32
Table 4.3	Rotated Factor and Factor Loadings of Relationship Marketing	34
Table 4.4	Rotated Factor and Factor Loadings of Customer Loyalty	35
Table 4.5	Summary of Reliability Analysis Results	36
Table 4.6	Simple Regression Results between IM and Trust	38
Table 4.7	Simple Regression Results between IM and Bonding	39
Table 4.8	Simple Regression Results between IM and Empathy	39
Table 4.9	Simple Regression Results between IM and Shared Value	40
Table 4.10	Simple Regression Results between IM and Reciprocity	41
Table 4.11	Multiple Regression Results between Relationship Marketing (Trust, Bonding, Empathy, Shared Value and Reciprocity) and Customer Loyalty	41
Table 4.12	Hierarchical Regression Results among Internal Marketing, Trust (Mediating Variable) and Customer Loyalty	43
Table 4.13	Hierarchical Regression Results among Internal Marketing, Empathy (Mediating Variable) and Customer Loyalty	44
Table 4.14	Summary of Hypothesis Testing Results	45

LIST OF FIGURES

Figure 2.1	Theoretical framework	<u>Page</u> 19
Figure 4.1	Revised theoretical framework	37

ABSTRAK

Baru-baru ini, banyak pengajian telah dibuat berdasarkan konsep pemasaran baru seperti pemasaran dalaman (IM) and pemasaran perhubungan (RM). Namun, tiada penyelidikan dikaji khas untuk mencari pertalian antara konsep pemasaran dalaman dan pemasaran perhubungan. Pengajian ini ditujukan untuk mengisi kekosongan penyelidikan lain dengan usaha menjalin perhubungan antara pemasaran dalaman, pemasaran perhubungan dan kesetiaan pelanggan dalam industri insuran. Daripada 150 borang soal siasat yang dihantar kepada agensi insurans dari negeri-negeri di utara Malaysia, 98 borang yang siap diisi telah diterima balik. Pertama sekali, dengan keputusan daripada borang soal siasat, perhubungan antara pemasaran dalaman dan pemasaran pertalian telah dikaji. Keputusan kajian menyokong hipotesis bahawa pemasaran dalaman berkaitan secara positif dengan pemasaran perhubungan. Seterusnya, kesan pemasaran perhubungan ke atas kesetiaan pelanggan telah disiasat. Didapati bahawa sebahagian daripada pemasaran perhubungan berkaitan secara positif ke atas kesetiaan pelanggan. Akhir sekali, pengajiian ini cuba memeriksa samada pemasaran perhubungan merupakan pembolehubah pencilah di antara perhubungan pemasaran dalaman dan kesetiaan pelanggan. Keputusan kajian mencadangkan bahawa kepercayaan dan empati adalah pembolehubah pencilah di antara perhubungan pemasaran dalaman dan kesetiaan pelanggan.

ABSTRACT

Recently, contemporary marketing concepts such as internal marketing (IM) and relationship marketing (RM) have been extensively researched. Although a lot of studies were carried out and literatures were published to discuss about these new concepts, there is no single research performed to establish the link between relationship marketing and internal marketing. This research aimed to study the relationship between internal marketing, relationship marketing and customer loyalty especially within the insurance industry. 98 completed questionnaires were collected from 150 insurance agencies in Northern states of Malaysia. The relationship between internal marketing and relationship marketing was first tested based on questionnaires collected. Statistical results suggested that internal marketing significantly and positively affected relationship marketing. Then, this research proceeded to understand the impact of relationship marketing to customer loyalty. The study revealed that relationship marketing partially lead to customer loyalty. Finally the mediating effect of relationship marketing on the relationship between internal marketing and customer loyalty was explored. Trust and empathy were components of relationship marketing found to be significant mediators.

Chapter 1

INTRODUCTION

1.1 Introduction

In the past two decades, contemporary marketing concepts such as internal marketing (IM) and relationship marketing (RM) have been extensively researched. Although a lot of studies (Gronroos, 1985; Rafiq & Ahmed, 2000; Ahmed, Rafiq & Saad, 2003; Varey & Lewis, 1999; De Bussy, Ewing & Pitt, 2003; Caruana & Calleya, 1998; Sin, Tse, Yau, Lee, Chow & Lau, 2000; Sin, Tse, Yau, Chow, Lee & Lau, 2005; Morgan & Hunt, 1994; Yau, McFetridge, Chow & Lee, 2000; Hart, Smith, Sparks & Tzokas, 1999) were carried out and literatures were published to discuss about these new concepts, there is no single research that has been performed to establish the link between relationship marketing and internal marketing. Gronroos (1994) stressed that internal marketing is required to make relationship marketing successful. However, he did not proceed further to discuss the relationship between these two concepts nor did he try to explain how they affect each other. The aim of this research is to explore and clarify the link between relationship marketing and internal marketing.

This chapter starts with the background and significance of the study. Problem statement, research objectives and research questions for this study will next be presented and discussed. Finally, this chapter ends with an explanation of the organization of the remaining chapters.

1.2 Background

Internal marketing concept was first introduced by Sasser and Arbeit (1976) and later by Berry (1981) who advocated that internal marketing is treating employees and

service personnel as internal customers. It has later emerged as a concept aimed at developing motivated, customer-conscious and sales mindedness employees by marketing like approach and by marketing-like activities internally (Gronroos, 1981; Gronroos, 1985). Internal marketing is widely accepted as an important concept in contributing to the people element of marketing mix and in achieving customer orientation throughout the organization. The implementation of internal marketing was further motivated as more researchers found positive relationship between employee satisfaction and service quality (Rafiq & Ahmed, 2000). Literatures also revealed that internal marketing has positive impact to organizations sustainable competitive advantage (Ballantyne, 1997; Sargeant & Asif, 1998).

Relationship marketing on the other hand focuses in establishing, developing and maintaining successful relationship with customer (Morgan & Hunt, 1994) was first introduced by literatures in the service industry (Berry & Parasuraman, 1991). It is considered as the alternative to traditional marketing concept which focuses mainly on transactional or attracting new customer. Relationship marketing shifts marketing towards maintaining long-term relationship with customers. This concept was later extended to not only the relationship between buyer and seller but also to the relationship with all the stakeholders of organization (Gummesson, 1994; Gronroos, 1994; Moller & Halinen, 2000). These literatures recognized that long-term profitability and success of an organization required all the stakeholders to move in common direction towards shared values and goals.

Although there are a lot of literatures discussed and proposed the relationship of IM or RM to the business performance of organization, there has yet to be a single literature that establishes the linkage between these two marketing concepts. Al-Khalili et al. (2003) revealed that RM leads to customer loyalty, however not many

empirical researches were carried out to prove the positive relationship between RM and customer loyalty. It will be even more interesting to understand how IM will affect the impact of RM to customer loyalty.

1.3 Significance of the Study

The purpose of this research is to establish the relationship between internal marketing and relationship marketing and how these two concepts affect customer loyalty. As the nature of business becomes more complex, challenging and involves intensive interaction of marketers, suppliers and customers, it is hoped that this research will provide valuable reference to companies when formulating their marketing strategies to create and enhance customer loyalty.

As the majority of literatures and research on IM or RM are concentrated on western countries, this research will be able to provide a better understanding of the acceptance and applicability of these concepts in the Malaysian context.

Although insurance industry can be considered as one of the service industry, there are limited IM and RM literatures published specifically on this industry. Hence, this research will be able to establish the relevance of IM and RM to insurance industry, how they are linked and how insurance agent can utilize these two concepts in increasing customer loyalty.

1.4 Problem Statement

How to enhance customer loyalty? Will internal marketing lead to customer loyalty and will relationship marketing mediate the relationship?

Researchers have found positive relationship between RM and customer loyalty (Al-Khalili, Saad & Ismail, 2003; Hart et. al., 1999), and suggested that RM

provides the organization the competitive advantage that is difficult for competitors to match, which results in high level of customer loyalty.

On the other hand, Gronroos (1994) and Ballantyne (2000) proposed that internal marketing is a prerequisite to successful relationship marketing. IM focuses on creating customer-consciousness and sales-mindedness among all employees. These are the critical values for highly customer-oriented organization in which every employee performs to his or her best effort in meeting the needs of external customers, which consequently establishes long-term profitable relationship with customers.

By combining these two schools of thought, we seek to establish the link among IM, RM and customer loyalty.

1.5 Research Objectives

Although IM and RM were studied extensively, not many researches were done in Malaysia. Hence, it is one of the objectives of this research to study the applicability and significance of these two concepts in this country. With strong multicultural background and significant foreign influence in the working environment through foreign direct investments, this research strives to explore whether IM and RM will bring similar results as proposed and proven by past literatures.

In addition to the above, this study also seeks to achieve the following objectives:

- (i) To determine the relationship between IM and RM.
- (ii) To determine the relationship between IM and customer loyalty.
- (iii) To determine the relationship between RM and customer loyalty.

1.6 Research Questions

This research attempts to answer the following questions:

- (i) Will IM lead to customer loyalty?
- (ii) Is IM the prerequisite to RM?
- (iii) Does RM impact customer loyalty?
- (iv) Does each components of RM affect customer loyalty?
- (v) How will IM lead to customer loyalty, is RM the mediating factor?

1.7 Organization of Chapters

The first chapter provided the background leading to this research, a brief introduction to IM and RM, the problem statement, research objectives, research questions and the significance of this study. In Chapter 2, reviews and discussions were made on past and relevant literatures concerning IM, RM and customer loyalty. Detailed definitions and arguments regarding these marketing concepts were covered in depth. Based on the literature reviews, theoretical framework for this research was presented together with the hypothesis generation. The third chapter covered the research methodology and design, which included but not limited to variables measurement, population and samples, questionnaire, and data analyses. Findings of this research and testing of all the hypothesis and establishment of relationship between all the variables were reported in Chapter 4. Finally, the last chapter wrapped up with a discussion on the findings, implications and limitations of this research as well as recommendations for future studies.

Chapter 2

LITERATURE REVIEW

2.1 Introduction

This chapter first highlights and discusses the findings and conclusions from previous literatures to provide a background of this study. Based on the literature review, theoretical framework and hypotheses are developed.

2.2 Internal Marketing

Internal marketing concept was initiated when organization adapted traditional marketing tools to market jobs to employees (Sasser & Arbeit, 1976). It was stressed that organizations must first sell the job to employees before it can sell their service to customers. Similar to marketing concept which stresses the importance of values exchange between two parties, Sasser and Arbeit (1976) viewed employer-employee relationship as a transaction. They view the selling of job to employees from marketing approach where the organization shall offer values appropriate to producing the desired responses from employees. Berry, 1981 viewed employees as internal customers and jobs as internal products. Hence, the job must be attractive and able to motivate employees to achieve the overall objectives of organization. Berry (1980) stated that the objectives of internal marketing are to employ and keep the best people, as well as to make the employees do the best possible job by applying philosophy and practices of marketing internally to the internal market of employees.

Since then, there has been a great deal of literatures published regarding internal marketing (Gronroos 1981; Gronroos, 1985; Rafiq & Ahmed, 2000; Ahmed et al., 2003; Varey & Lewis, 1999; Sargeant & Asif, 1998; Ballantyne, 1997; De

Bussy et al., 2003; Doukakis, 2003; Caruana & Calleya, 1998). The main objective of the IM function is to obtain motivated, customer-conscious and sales-minded employees (Gronroos, 1981). Gronroos (1985) went a step further to suggest that internal marketing is to motivate employees towards customer-consciousness, market orientation and sales-mindedness by marketing like approach internally. Berry and Parasuraman (1991) defined IM as attracting, developing, motivating and retaining qualified employees through job-products that satisfy their needs.

Gronroos (1981) proposed that there are two levels of IM, the strategic level and the tactical level. At strategic level, internal environment that support customer-consciousness and sales-mindedness among employees should be created. Organization should work to make sure the employees feel that management are supportive of the internal marketing concept through supporting management methods, supporting personnel policy, supporting policy of internal training, and supporting planning procedures.

At the tactical level, firstly organization needs to ensure that the employees realize the importance and the consequences of their roles, not only of their job function but also of them as an income generating marketing resource. Organization must work to sell new services, auxiliary services, campaigns, and other marketing efforts or initiatives which might influence the customers to their employees. The internal market of employees is best motivated for sales-mindedness and customer-oriented behavior by an active, marketing like and coordinated way (Gronroos, 1981). Effective internal information and communication system are critical at the tactical level. This concept was further discussed and implemented by Richardson and Robinson (1986). Greene et al. (1994) highlighted that IM must be supported by marketing programs like training, collateral materials and information systems. De

Bussy et al. (2003) viewed effective two ways communication between employees and management as being essential to the success of internal marketing strategies. When internal communication is done parallel with external marketing communications, the organization will be more capable to fulfill its promises to customers because their employees are better prepared to perform the organization's commitment (Ahmed & Rafiq, 2003).

Gronroos (1985) and Greene, Walls and Schrest (1994) stressed the importance of obtaining top management acceptance and support of IM concept to ensure the IM could become part of the strategic management philosophy. In order for IM to be successful, it is important that IM is embraced by top management and must be enforced based on a top-down approach.

Regarding the implementation of IM, Tansuhaj, Randall and McCullogh (1988) stated that a comprehensive IM program should focus on employee recruitment, training, motivation, communication and retention. Greene et al. (1994) suggested that effective IM program should focus on product or service segments which are more effective and efficient with IM, existence of rewards system to encourage IM supported by marketing programs and finally on creating organization harmony via good co-ordination among all parties within the organization. Foreman and Money (1995) found that there are three major components of IM. They are employee development, rewards to employee and vision which is defined as "*giving something for the employees to believe in*".

Literatures suggested that implementation of IM require changes in organization culture and practices which need cross-functional approach and involves extensive internal relationship management (Ahmed & Rafiq, 2003; Cahill 1995; Gronroos, 1981; Gronroos 1985; Saad et al., 2002; Varey, 1995). Internal marketing

concept suggests that every function in an organization has to be responsible for the value of customer satisfaction. Internal marketing stresses the importance of having multiple functions and people with different skills work together actively in delivering quality products or services. In order to achieve this, organization needs to formulate and manage cross-functional team activities effectively. Specifically, significant resources should be devoted to identifying ways to improve mid to low organizational level cross-functional team, where there is a potential great impact on organizational effectiveness. Hence, organization should reform the reporting structures, working processes and reward systems to encourage and facilitate effective cross-functional processes. With the massive cross-functional and inter-departmental activities, it is important for each individual within the organization to see his/her role and impact to the next internal customer. Creating, aligning and maintaining good internal relationship within organization will highly influence the performance of company and employees.

Ballantyne (1997) when defined IM as a relationship development strategy for the purpose of knowledge renewal, proposed four modes of activities during the implementation of IM concept in organization. They are “energizing”, “code breaking”, “authorizing” and “diffusing”. Varey (1995) cited IM as a process and mechanism to ensure effective responsiveness to environmental changes, flexibility for efficiently adopting newly designed administrative arrangement and continuous improvement in performance.

2.3 Relationship Marketing

Relationship marketing was introduced by service industry literatures in 1970s and 1980s (Aijo, 1996). During the early stage, its main goal was to create customer

loyalty via establishing relationship between individual customer and service personnel. Literatures suggested that customer satisfaction is highly related to the interaction relationship between customer and service personnel (Gronroos, 1990; Berry & Parasuraman, 1993). This concept of RM which is more customer-oriented is regarded as market-based RM by Moller and Halinen (2000). Gronroos (1990) proposed that relationship marketing should include long term customer focus, making and keeping promise to customer, involve company-wide non-marketing personnel in marketing activities, implementing interactive process to marketing by developing customer oriented service culture and by acquiring and using customer database. The introduction of RM has shifted traditional transactional marketing which focuses on acquisition of sales toward building long term relationships with customers (Kotler, 1991; Peterson, 1995; Gronroos, 1994). Sin et al. (2005) concluded relationship marketing concept as firm's philosophy or organization culture which places buyer-seller relationship at the centre of firms' strategic thinking or decision making process.

Relationship marketing was later viewed as not only the relationship between organization and customers but also the relationships between organization and its stakeholders both inside and outside the organization such as employees, suppliers, competitors, governments and so on, which some has regarded as network-based relationship marketing (Gummesson, 1994; Gronroos, 1994; Moller & Halinen, 2000). Morgan and Hunt (1994) widely discussed the concept of relationship exchanges between the firm and its internal employees, buyer, lateral and supplier partners. They proposed that RM refer to all marketing activities which focus on establishing, developing and maintaining successful relational exchanges between all

the partners. One of the widely accepted definitions of RM was proposed by Gronroos (1994):

“...to establish, maintain and enhance relationships with customers and other partners, at a profit, so that the objectives of the partners are met. This is achieved by mutual exchange and keeping of promises.”

Researches on “Guanxi” in marketing literature in China also contributed significantly to RM (Sin et al., 2005). Chinese believe that one should first build relationship and transactions will follow if the relationship is successful (Ambler, 1994).

Past literatures (Sin et al., 2000; Sin et al., 2005; Morgan & Hunt, 1994; Yau et al., 2000; Hart et al, 1999) have suggested six significant behavioral components of RM which are trust, bonding, communication, shared value, empathy and reciprocity. Each of these components will be discussed in more detail in the following section.

2.3.1 Trust

Morgan and Hunt (1994) defined trust as existing when both exchange partners have confidence in each others reliability and integrity. With the existence of trust, business partners will feel that they could rely on integrity and promise made by the exchange partners. According to Gronroos (1994), trust exists with a belief in the other partner’s trustworthiness resulting from expertise, reliability or intentionality of the partner. The same literature also suggests that trust could also be a behavioral intention that reflects the reliance on each other. In service marketing, trust is highly rated. This is because customers normally purchase the service prior to experiencing it. Morgan and Hunts (1994) summarized that trust is important to the success of alliance and trust is also one of the basis for customer loyalty. Hence, high trust level is one of the key

factors to determine whether relationship between partners will last for the long term. Literatures confirmed trust as one of the significant components in relationship marketing.

2.3.2 Bonding

Callaghan, McPhail and Yau (1995) defined bonding as the component of business relationship that will result in business partners acting in a unified manner towards desired goals. Yau et al. (2000) indicated that bonding could be developed via collaboration and cooperation efforts to create common identity between business partners. The collaborative efforts could include join effort in designing a product, building quality control, developing long term planning or even sharing of technologies and knowledge between partners. Strong bonding between business partners will lead to closer and long-term relationship.

2.3.3 Communication

Communication, which sometime also known as dialogue, (Hart et al., 1999) refers to interactive behavior to enhance knowledge of customers and hence generate more innovative ideas to meet customers' demands. Sin et al. (2005) defined communication as formal and informal exchange or sharing of meaningful and timely information among two parties. Gronroos (2004) suggested that a planned communication process is necessary to support the development and enhancement of relationship among stakeholders. The same literature also highlighted that in order to make RM successful, a well integrated marketing communication is critical to support the establishment, maintenance and enhancement of relationships with stakeholders.

2.3.4 Shared Value

Morgan and Hunt (1994) defined shared value as the extent to which business partners have common beliefs in behaviors, goals and policies. Ambler (1994), in the study of “Guanxi”, indicated that it is very important to understand and share the value and culture of partners in order to build and maintain sustainable relationship. Sin et al. (2005) confirmed that exchange partners who share common values will be more committed to their relationships.

2.3.5 Empathy

Empathy refers to the component of business relationship which enables two parties to see the situation from the other’s perspective (Sin. et al., 2005). Understanding each other’s needs, desire and concerns will help one to comprehend and predict the other’s behavior and hence create more appreciation for the other party. Effective marketers will first seek to understand the actual needs of customers and then offer products which fulfill the needs of the customers. Empathy is equally important to responsible employer who seeks to establish long term relationship with his or her employees. The employer will first understand the needs of employees and the reasons for certain behaviors among employees, and then design the best approach to meet the needs for both parties.

2.3.6 Reciprocity

Callaghan et al. (1995) referred to reciprocity as either party providing favors or making allowance for the other party, and in return, the other party provides similar favors or allowances to be received at a later date. Yau et al. (2000) suggested that reciprocity could be summarized into “bilateral contingency” which is the obligation

of recipient to repay favor gave by another party, “interdependence for mutual benefit” which means the party who does the favor to the recipient intends to obtain something from the recipient and “equality of exchanged values” in social action between two parties. Reciprocity is in fact the culture or values of most Asians in promoting harmony and long lasting relationship with others.

2.4 Customer Loyalty

Customer loyalty is seen as one of the critical factors for the success of an organization. Jacoby and Chestnut (1978) suggested that customer loyalty is the behavioral outcome of a customer’s preference for a particular brand from a selection of similar brands, over a period of time, after an evaluative decision-making process (McMullan & Gilmore, 2003). In general, customer loyalty could be divided into behavioral and attitudinal or psychological elements (Hart et al, 1999; Too, Souchon & Thirkell, 2001). Behavioral element links customer loyalty to repeat purchase or patronage of a certain products, whereas attitudinal or psychological component is supported by adjacent constructs like commitment and involvement of customers which eventually lead to repeat purchase (Hart et al, 1999). Without the attitudinal component, repeat purchase behavior might not be a true representation of customer loyalty as it could be due to the lack of alternatives products, consumers’ habitual effect or some other factors.

Dick and Basu (1994) conceptualized customer loyalty as the strength of relationship between individual’s relative attitude towards an entity and repeat patronage behavior. A similar definition of customer loyalty is also quoted in Too et al. (2001) where it defined customer loyalty as *“the proportion of times a purchaser chooses the same product or service in a category compared with his or her total*

number of purchases in the category, assuming that acceptable competitive products or services are conveniently available". Oliver (1999) suggested that for customer to remain loyal, he or she has to believe that the particular product is the best choice alternative, and he or she must do this while naively shunning communications from competitive products which argue that the product that he or she is loyal to is no longer the most efficient, lowest price or highest quality of its kind.

As discussed by literatures (McMullan & Gilmore, 2003; Oliver, 1999; Sawmong & Omar, 2004), Oliver's four-stage loyalty model defines loyalty as four progressing phases which are cognitive loyalty, affective loyalty, conative loyalty, and action loyalty. In the first cognitive loyalty phase, loyalty is directed toward information available which creates the perceptions of the cost, quality and benefits of the products or services. Loyalty at this phase is shallow.

At the second phase of loyalty, a liking or attitude toward the products or services has developed on the basis of cumulatively satisfying usage occasions. Commitment at this phase is referred to as affective loyalty and is encoded in consumers' mind as cognition and affect.

The third phase of loyalty is known as conative loyalty. This behavior intention stage of loyalty emerges with the influence of repeated positive affect toward the product or brand. At conative phase of loyalty, commitment to the intention to re-buy the product or brand is deeply held by customers.

The final phase of loyalty is the action loyalty. In action loyalty, the intention to purchase developed in the first three loyalty phases is transformed into readiness to act. At this loyalty phase, customers will also possess the desire to overcome obstacles that prevent the repurchase action. This is an important factor that keeps customers loyal even under undesirable situation where switching behavior is

encouraged. These four phases of customer loyalty explain the progress of attitudinal loyalty to the behavioral loyalty and eventually resulting in the action of repeat purchase.

2.5 Internal Marketing and Relationship Marketing

Greene et al. (1994) concluded that internal marketing is the key factor to superior service which leads external marketing success. This relationship was also proposed by Gronroos (1994) who quoted that thorough and on-going internal marketing process is required for a successful relationship marketing. As discussed earlier, relationship marketing requires a shift in marketing paradigm and the implementation needs changes in corporate culture. Hogg, Carter and Dunne (1998) found that internal marketing affects change in organization culture.

Hunt and Morgan (1994) identified internal market and internal partnerships as two of the important components of relationship marketing. In addition to that, Holmlund and Kock (1996) argued that retaining and empowering front line personnel, which are stressed by internal marketing, is essential to successful relationship marketing.

Barnes, Fox and Morris (2004) proposed that relationship marketing and internal marketing have become somewhat intertwined. Whilst relationship marketing focuses on bringing the external customer into the company, internal marketing stresses the importance for management to view the company as a market with supply chain of internal suppliers and customers. As discussed by Hartline, Maxham and McKee (2000), customer orientation is only likely to occur when an appropriate design and structure is in place internally within the organization. Internal marketing is the strategic tool for the organization to create a sense of customer consciousness

among employees in order to deliver the commitment and promises to external customers.

These lead to the development of the first hypothesis:

H₁ : IM is positively related to relationship marketing

From the first hypothesis, six additional hypotheses are developed between IM and the components of relationship marketing:

H_{1a} : IM is positively related to trust

H_{1b} : IM is positively related to bonding

H_{1c} : IM is positively related to empathy

H_{1d} : IM is positively related to communication

H_{1e} : IM is positively related to shared value

H_{1f} : IM is positively related to reciprocity

2.6 Relationship Marketing and Customer Loyalty

Relationship marketing is considered to be one of the tools to build loyalty with customers (Hart et al, 1999). This article emphasizes the importance of customer knowledge and direct customer communication to the generation of strong customer loyalty. Reynolds and Arnold (2002) provided evidence showing that customer's loyalty to sales personnel via relationship marketing has strong and positive effects to the store's loyalty. Ennew and Binks (1996) argued that the recent developments in relationship marketing have increasingly focused attention on the beneficial effects of customer retention. Building relationships to enhance customer loyalty is particularly critical to the service industry as customer attraction costs are significantly higher than customer retention costs.

Too et al. (2001) also quoted that one of the ways to increase customer loyalty and retention is through secure relationships between buyer and seller. It was suggested that relationship marketing could provide customer benefits that might be difficult for competitors to match and hence resulted in greater customer loyalty. The same article revealed that customers' perceptions of organization's relationship marketing efforts are crucial to enhance customers' commitment and loyalty. Similar conclusions were drawn by Al-Khalili et al. (2003) that both market orientation and relationship marketing will lead to customer loyalty and retention. While discussing Customer Relationship Management (CRM), Dowling (2002) stressed that developing relationship with customer is the best way to get them to become loyal, and loyal customers are more profitable than non-loyal customers.

Based on the above literatures, hypothesis between RM and customer loyalty is generated.

H₂ : RM will lead to customer loyalty

From the above hypothesis, six additional hypotheses are developed between each individual components of IM and customer loyalty.

H_{2a} : Trust is positively related to customer loyalty

H_{2b} : Bonding is positively related to customer loyalty

H_{2c} : Empathy is positively related to customer loyalty

H_{2d} : Communication is positively related to customer loyalty

H_{2e} : Shared value is positively related to customer loyalty

H_{2f} : Reciprocity is positively related to customer loyalty

2.7 Theoretical Framework

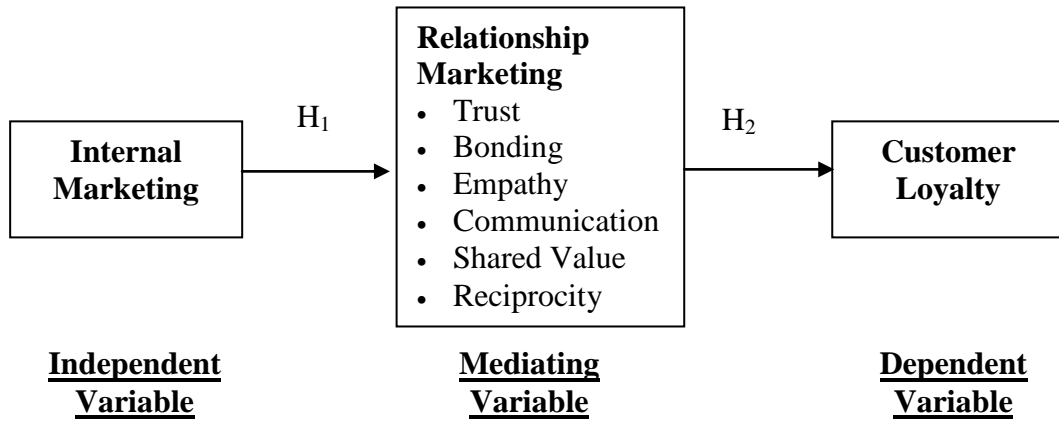


Figure 2.1. Theoretical framework

Based on the literatures review and hypotheses generated, the theoretical framework for this study is constructed as shown in Figure 2.1. As discussed earlier, previous literatures found a positive relationship between IM and RM (Gronroos, 1994; Ballantyne, 2000). Extensive researches were also carried out to prove the relationship between RM and customer loyalty (Hart et al., 1999; Too et al., 2001; Ravald & Gronroos, 1996). However, there was limited research performed to understand the relationship among IM, RM and customer loyalty. It is hoped that this theoretical framework will be able to provide answers the research questions.

Ennew and Binks (1996) discussed briefly on the relationship among internal marketing, relationship marketing and customer loyalty. According to this article, employees who are more satisfied with their job will typically deliver better quality services. These employees will also tend to remain with the company for a long period of time, hence they are able to build long-term relationship with customers. With the relationships built, customers will be more satisfied and loyal to the company as they tend to receive better services from these employees. Enhanced

customer satisfaction will result in enhanced employee satisfaction thus creating a “virtuous circle”. In the same article, Gronroos (1990) stressed that internal marketing plays an important role in developing this self reinforcing relationship.

By relating the first and second hypothesis, the final hypothesis is generated.

H₃ : RM mediates the relationship between IM and customer loyalty.

Chapter 3

METHODOLOGY

3.1 Introduction

In the early part of this chapter, the research design, sampling and research procedure is covered. It will then be followed by questionnaires design, explanations on measurements and finally elaboration on how the data will be analyzed.

3.2 Research Design

The purpose of this study is to establish the relationship among internal marketing, relationship marketing and customer loyalty in insurance industry. Variables of this research are measured from primary data collected using self-administered questionnaires. The population of this study is made up of insurance agencies in the northern region of Malaysia, mainly from Penang and Kedah. The unit of analysis is insurance agency which will be represented by an insurance agent or marketing personnel from the respective agency. The level of analysis is at organization level where each insurance agency is considered an organization.

3.3 Sampling and Procedure

Convenient sampling was conducted by distributing questionnaires through agencies of insurance companies, as discussed in the research design. A total of 150 sets of questionnaires were distributed and 98 questionnaires were completed and returned. Among the 98 completed and returned questionnaires, 94 were good to be used.

3.4 Measurement

The questionnaire was adapted from previous literatures with modifications to accommodate into this research. Table 3.1 to Table 3.3 showed the summary of measures, while the full questionnaire was shown in Appendix A. The questionnaire was divided into four sections. Section A consisted of questions regarding internal marketing and were numbered from 1 to 15. Section B was made up of twenty two questions about relationship marketing with questions 16 to 37. This section was subdivided into six components of relationship marketing, which were trust, bonding, communication, shared value, empathy and reciprocity. The third section, section C, assessed customer loyalty based on questions 38 to 43 were to measure customer loyalty attitude while the remaining questions 44 to 47 were to evaluate customer loyalty behavior. The final section, section D, were questions regarding demographic information.

Questions in section A, B and C were in the form of statements on a five-points Likert-scale, anchored on 1 = *strongly disagree*, through 5 = *strongly agree*.

The questionnaire was distributed together with a signed cover letter explaining the purpose of this study and assurance of anonymity and confidentiality. In addition, respondents were also assured that the data collected was strictly for the purpose of this study and no agencies or organizations would have access to any of the data provided.

3.4.1 Internal Marketing

Internal marketing was the independent variable of this research. Questions used for measuring the importance of internal marketing in the organization were adopted from the instrument developed by Foreman and Money (1995). According to this

literature, the questions were generated from the combination of focus group discussions with services marketers on an executive course at a business school, checklist on IM from Berry and Parasuraman (1991), and IM items in service marketing audit of Berry et al. (1991). The same instrument was later used and validated by Caruana and Calleya (1998) in the study of the effect of IM on organizational commitment among retail bank managers. Naude et al. (2002) also utilized the same 15 questions to understand factors that may influence employee's perception of their company's level of internal marketing orientation.

3.4.2 Relationship Marketing

Relationship marketing orientation (RMO) was used to measure the extent to which the company was involved in developing and maintaining long term relationship with its customers. A 22-items RMO scale adapted from Yau et al. (1999) and Sin et al. (2002) was used to assess the extent to which relationship marketing was practiced in the company. The same set of questions was validated by Sin et al. (2005) in the study of the scale development and cross-cultural validation of relationship marketing orientation. The questions consisted of six behavioural components of RMO, i.e., bonding, empathy, reciprocity, shared value, communication and trust. Respondents were required to indicate on a 5-point scale (1 = *strongly disagree*; 5 = *strongly agree*) the degree of their agreement with each statement describing their relationship with their major customers.

3.4.3 Customer Loyalty

In this research, customer loyalty was measured based upon attitudinal and behavioral components. Ten items measuring this construct were adapted from Pearson (1996), Sirohi et al. (1998), and Too et al. (2001). Respondents were required to indicate on a

5-point scale (1 = *strongly disagree*; 5 = *strongly agree*) the degree of their agreement with each statement describing their major customers.

Table 3.1

Summary of Measure: Internal Marketing

-
1. Our company offers agents a vision that we can believe in.
 2. Our company's vision is well communicated to all agents.
 3. This company prepares agents to perform well.
 4. Our company views the development of knowledge and skills in agents as an investment rather than cost.
 5. Skill and knowledge development of agents happens as an ongoing process in our company.
 6. We teach our agents "why they should do things" and not just "how they should do things."
 7. This company goes beyond training and educates agents to work together.
 8. In this company, agents are properly trained to perform their service roles.
 9. This company places considerable emphasis on communication with agents.
 10. This company has the flexibility to accommodate the differing needs of agents.
 11. This company measures and rewards agents performance that contributes most to our company's vision.
 12. Data gathered from agents is used to improve jobs, and to develop the strategy of the company.
 13. In our company, those agents who provide excellent service are rewarded for their efforts.
 14. Our performance measurement and reward systems encourage agents to work together.
 15. Our company communicates to agents the importance of their service roles.
-